

**DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS NUMBER: 06-0076
Gross Income & Adjusted Gross Income Tax
For the Years 1998-2002**

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ISSUES

I. Adjusted Gross Income Tax—Net Operating Losses

Authority: *Phoenix Coal Co. v. Comm'r*, 231 F.2d 420 (2d Cir. 1956)

Taxpayer protests the reallocation of net operating loss carrybacks based on a redetermination of its income for a prior year.

II. Tax Administration—Penalty

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of the ten percent penalty for negligence.

STATEMENT OF FACTS

Taxpayer is an out-of-state corporation. The Department redetermined Taxpayer's carryforward and carryback of a taxable year 2000 net operating loss. Taxpayer protested this issue.

In addition, Taxpayer protested a gross income tax assessment. Without further discussion, Taxpayer's protest is sustained with respect to the gross income tax issue.

I. Adjusted Gross Income Tax—Net Operating Losses

DISCUSSION

Taxpayer protests the Department's recalculation of Taxpayer's 2000 net operating losses carried back to the years 1998 and 1999. The Department determined that Taxpayer's underreported its 1998 sales numerator. As a result, Taxpayer reported a lower share of income apportioned to Indiana than it should have reported, and the Department increased Taxpayer's 1998 Indiana income. Thus, more of Taxpayer's taxable year 2000 net operating loss should have been used in 1998 and none of the net operating loss should have been used in 1999.

The redetermination did not result in any additional liability. However, to illustrate the effect of the redetermination, the redetermination potentially could result in the use of net operating losses to offset additional income in prior years, leaving a lesser amount to be used (and more taxable

income) in later years. The actual effect of the net operating loss redetermination for years after the periods protested is not apparent from the Department's protest file.

While Indiana statutes and case law have not dealt with this particular situation, federal law governing net operating losses has dealt with this situation. In *Phoenix Coal Co. v. Comm'r*, 231 F.2d 420 (2nd Cir. 1956), a corporation incurred a net operating loss in 1947. The corporation carried back its net operating losses to eliminate its 1945 income and reduce its 1946 income. The corporation incurred a further net operating loss in 1948, which served to eliminate its 1946 income.

The Bureau of Internal Revenue (B.I.R.) reviewed the corporation's returns. Upon review of the corporation's returns, the B.I.R. determined that the corporation had underreported its 1945 income. Accordingly, the B.I.R. redetermined the amount of net operating losses that could be carried forward to 1946, and assessed additional tax for that year. At the time of the assessment, the statute of limitations for imposition of additional 1945 tax had expired, though the statute of limitations had not expired for 1946. The court held that, though taxes for 1945 could not be assessed due to the passing of the statute of limitations, the income for 1945 could be redetermined to compute the proper amount of net operating losses allowable for 1946. *Id.* at 421-422.

Here, Taxpayer's contentions with respect to the net operating loss carryforwards cannot be accepted. The Department has sought to revisit the determinations of the proper amount of net operating losses, along with carryforwards and carrybacks, for the prior audit period and any previous years solely for purposes of determining the proper amount of income subject to tax for years after 2000. This is similar to the B.I.R. in *Phoenix Coal*, which recomputed the corporation's income for 1945 to determine the proper income for 1946. The Department's redetermination of Taxpayer's net operating loss carrybacks does not permit assessment (except for federal audit adjustments) for 1998 and 1999, just as the Commissioner's redetermination for 1945 did not permit assessment for that year. Thus, because the Department's redetermination of net operating loss carrybacks was proper to determine the tax liability for years potentially open to assessment, the Department was correct in reviewing and redetermining Taxpayer's application of its net operating losses for 1998 and 1999.

FINDING

Taxpayer's protest is denied.

II. Tax Administration—Penalty

DISCUSSION

Taxpayer argues that it is not subject to negligence penalties with respect to the additional taxes assessed. In particular, Taxpayer argues that the additional tax was due to its different, but reasonable, interpretation of the statute. Accordingly, Taxpayer argues that it was not negligent in preparing its tax returns and computing its tax liability for the years in question.

Penalty waiver is permitted if the taxpayer shows that the failure to pay the full amount of the tax was due to reasonable cause and not due to willful neglect. IC § 6-8.1-10-2.1. The Indiana Administrative Code, 45 IAC 15-11-2, further provides:

(b) "Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

(c) The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

Except for the substantive issue on which Taxpayer was previously sustained, Taxpayer has not provided sufficient information to justify waiver of the penalty.

FINDING

Taxpayer's protest is denied.